Thursday, January 24, 2002

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT NORTHERN DISTRICT OF CALIFORNIA

This court held a hearing on November 9, 2001 to make additional determinations upon remand from the Ninth Circuit Bankruptcy Appellate Panel (BAP). Gary M. Kaplan and Anthony de Alcuaz appeared for Plaintiff Nikon Precision, Inc. (NPI). John Chu appeared for Defendant Etsuko Tsurukawa (Etsuko). Upon due consideration, the court finds that Etsuko's husband, Takehiko Tsurukawa, acted as Etsuko's agent in perpetrating the wrongful acts in question, and that judgment should once again be entered for NPI, determining Etsuko's liability to NPI to be nondischargeable.

BACKGROUND

Takehiko Tsurukawa (Takehiko) worked for NPI. He and Etsuko also owned a business known as High Innovation. Takehiko caused NPI to refer certain NPI repair work to High Innovation, without disclosing to NPI his interest in High Innovation. High Innovation caused the repair work to be performed by a third party, then charged NPI more than High Innovation paid that third party. After NPI discovered this scheme, Takehiko and Etsuko stipulated to entry of a state-court judgment in the amount of $ 2,000,000. The judgment contained detailed stipulations of fact regarding the scheme and Takehiko's role in that scheme.

This court previously entered a judgment determining that neither Takehiko nor Etsuko could discharge this judgment in their chapter 7 bankruptcy case. I determined on NPI's motion for summary judgment that the stipulated judgment established that Takehiko had obtained funds from NPI under false pretenses, and that under principles of collateral estoppel, NPI was entitled to a judgment that Takehiko's liability was nondischargeable pursuant to 11 U.S.C. § 523(a)(2). Because the stipulated judgment did not specify the role Takehiko's wife Etsuko played in the fraudulent scheme, I held a

trial to determine whether her liability under the judgment was also nondischargeable. At the end of the trial, I determined that Takehiko's wrongful conduct should be attributed to Etsuko, because (1) the fraud occurred in the ordinary course of business of High Innovation, (2) Etsuko participated significantly in that business, (3) Etsuko benefitted from the wrongful conduct, and (4) Etsuko had reason to suspect that Takehiko was engaged in wrongful conduct.

The Bankruptcy Appellate Panel (BAP) reversed the judgment with respect to Etsuko. Tsurukawa v. Nikon Precision, Inc. (In re Tsurukawa), 258 B.R. 192 (Bankr. 9th Cir. 2001). The BAP held that this court applied the wrong legal standard in determining whether Etsuko should be held responsible for Takehiko's wrongful acts. For the purpose of determining whether a debt is nondischargeable, the BAP held, one spouse may be held vicariously responsible for the wrongful acts of the other spouse only if the first spouse committed the wrongful acts as agent for the second spouse. Id. at 196-98. The BAP directed this court to determine whether Etsuko was vicariously responsible for Takehiko's acts under the correct legal standard and, if not, whether Etsuko knowingly participated in the fraudulent scheme. Specifically, the BAP stated, "[w]e reverse and remand to the bankruptcy court for a determination as to whether (1) an agency relationship existed between Debtor and Takehiko or (2) Debtor had the requisite fraudulent intent to deceive Nikon." Id. at 198.

AGENCY

Under California law, "[a]n agent is one who represents another, called the principal, in dealings with third persons. Such representation is called agency." Cal. Civ. Code § 2295. The Restatement defines agency in a similar way. "Agency is the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act." Restatement (Third) Agency, § 101 (Tentative Draft No. 2, 2001).

Partners are agents for each other. "All partners are bound by the fraud of one acting within the scope of his authority in a partnership transaction with innocent third parties, in the same way in which a principal is responsible for fraud of his authorized agent." 9 Witkin, Summary of California Law, Partnership §40 at 435 (9th ed. 1989)(citing Zemelman v. Boston Ins. Co., 4 Cal. App. 3d 15, 18 (1970)). Under California law, the governing factor in determining whether co-owners are partners is whether they intend to operate a business together.

The intention of the parties to carry on as co-owners a definite business is ultimately the test of partnership. If they associate together and carry on a business, a partnership is normally created. It is immaterial that they do not so designate the relationship, or do not know they are partners, for the intent may be implied from their acts.

Id. § 24 at 423.

Applying these standards, I find that Takehiko acted as Etsuko's agent in performing the tortious acts at issue in this lawsuit.

First, finding Etsuko to be a principal and Takehiko to be her agent is consistent with what Etsuko represented to the public to be her role in High Innovation. Etsuko signed many documents submitted to

public agencies in which she represented that she was the sole owner of High Innovation. Those documents include sales tax returns filed with the California State Board of Equalization, forms submitted to the California Franchise Tax Board, and a fictitious business name statement submitted to the City and County of San Francisco. Documents submitted to public agencies must be presumed to have been completed and submitted in good faith, and it must therefore be presumed that the documents at issue here accurately reflected Etsuko's role in the business. Pearson v. Norton, 230 Cal. App. 2d 1, 12 (1964).

Second, I would find an agency relationship between unmarried persons who had the same economic relationship as Etsuko and Takehiko. If A and B are unmarried, A holds herself out to the public as sole owner of a business, B conceived the business and makes all business decisions, A deposits and writes checks for the business, and A and B share the profits of the business, the most natural conclusion is that B manages A's business as A's agent, or that A and B are partners.[1] Such are the facts here. Takehiko conceived the idea for the business and managed all aspects of the business. Etsuko performed numerous functions for the business, including signing the lease for the company's Judah Street premises, signing the forms used to open a company bank account at Bank of America for which she was originally the sole signatory, signing the application for a company credit card, writing many checks on the company account, depositing many checks payable to High Innovation, and handling some of the maintenance and repairs regarding the Judah Street premises. The evidence indicates that both Etsuko and Takehiko consented to perform the respective roles described above.

I recognize that one must be careful with this type of analysis. "[T]he assumption of [business functions] by a spouse may not carry the weight that such conduct on the part of a stranger would imply . . . ." Id. at 12. Thus, it is not appropriate to find an agency relationship in every instance in which a spouse takes bare legal title to business property held for the benefit of the couple, or where one spouse performs minor services for a business run by the other spouse. It is also inappropriate to find a partnership in every instance in which spouses share the profits of an enterprise, because under community property law a husband and wife generally share the profits of a business managed by either spouse. This is not such a case. By holding herself out as sole owner of High Innovation and by performing substantial activities for the business, Etsuko assumed an active role in High Innovation that goes beyond merely holding a community property interest in her husband's business and performing minor services for that business.

The most difficult question to answer in determining whether Takehiko acted as Etsuko's agent is whether Etsuko had the requisite degree of control. She clearly did not control the business in the most common sense of the word, in that she did not control the day-t--day management of the business. Exercise of such a degree of control is not necessary. "The control or right to control needed to establish agency may be very attenuated and there may even be an understanding between the master and servant that the employer shall not exercise control." Love v. Smith (In re Smith), 98 B.R. 423, 426 (Bankr. C.D. Ill. 1989)(citing Restatement (Second) Agency § 220 comment d).

In Smith, the debtor's husband wanted to open a used car dealership. He couldn't get the requisite license because he was a convicted felon. The debtor obtained the license and took ownership of the business and its bank account in her name, but did not participate in management of the business. The husband converted the proceeds of a used car left on consignment. The bankruptcy court found the debtor liable for her husband's tort, and held the resulting debt nondischargeable, on the basis that the debtor's husband had acted as her agent. With respect to the question of control, the court stated:

Although the testimony indicated that Bob Smith ran the business . . . and that Pamela K. Smith did not participate in any of the decision making or management of the business, she did exercise control over Bob Smith because the license was in her name. She was the only person authorized to sign checks, and she actually enabled Bob Smith to operate the business.

Id. at 426.

The type and degree of control present here are similar to that found sufficient in Smith. In Smith, the wife's represen-tation of ownership was necessary to satisfy a *legal requirement* for continued operation of the business. The husband could not legally operate the dealership without a license that only his wife could obtain. The wife exercised control in that her husband could operate the business only so long as she agreed to hold herself out as the sole owner of the dealership. In the present case, Etsuko's representation of ownership satisfied a perceived *practical requirement* for the execution of Takehiko's fraudulent scheme. Takehiko apparently believed that keeping his name off the business would make it harder for his employer to discover his self-dealing. Etsuko retained control over Takehiko in that he could pursue this concealment strategy only so long as Etsuko agreed to hold herself out as the sole owner of the business.

The decision of the BAP prominently noted various facts regarding Etsuko: that she is agoraphobic and only rarely leaves her home; that she spends the majority of her time caring for three children, one of whom is autistic; and that she is not financially sophisticated. Tsurukawa, supra, 258 B.R. at 193 n.3. I believe these facts have only a limited bearing on the question whether Takehiko was Etsuko's agent or partner. The facts noted above indicate that Etsuko likely did not spend much time thinking about the business of High Innovation, and that she may not have understood fully that the profits of the company were derived from a fraud upon NPI.[2] These facts do not indicate that Etsuko did not agree to act as the principal of High Innovation, that she did not understand that she was representing herself to the public as the owner of the company, that she did not perform the other functions for High Innovation previously noted, or that she did not undertake these functions voluntarily. In short, the facts noted by the BAP make Etsuko a sympathetic defendant and create some doubt as to whether Etsuko intended to defraud NPI, but do not outweigh the facts that indicate that Etsuko was a principal or partner in High Innovation.

Etsuko argues that because of a recent change of law, she may not be held responsible for acts committed by her husband even if he performed those acts as her agent. She notes that the BAP relied upon In re Cecchini, 780 F.2d 1440 (9th Cir. 1985) in holding that a principal may be vicariously responsible for the tortious acts of an agent. She argues that this doctrine is no longer applicable, because the Ninth Circuit overruled Cecchini after the BAP issued its opinion in this case. This argument is unpersuasive. The Ninth Circuit decision in question, In re Pecklar, 260 F.3d 1035 (9th Cir. 2001), discussed the portion of Cecchini that addressed whether a tort is "willful and malicious," not the portion of Cecchini that addressed vicarious responsibility for acts of an agent. Id. at 1037-38.

In my previous decision, I found that Takehiko's tortious acts were within the ordinary course of the business of High Innovation, and that Etsuko benefitted from Takehiko's tortious acts. Takehiko thus acted within the scope of his agency in performing the tortious acts in question, and it is therefore appropriate to hold Etsuko responsible for those acts in determining the discharge-ability of her liability to NPI.

FRAUDULENT INTENT

In light of the determination that Takehiko acted as Etsuko's agent when he defrauded NPI, it is unnecessary to determine whether Etsuko herself intended to defraud NPI.

CONCLUSION

Judgment will be entered determining Etsuko's liability to NPI under the stipulated judgment to be nondischargeable pursuant to 11 U.S.C. § 523 (a)(2).

Dated: January 14, 2002 _____ Thomas E. Carlson United States Bankruptcy Judge

1. To the extent it is inappropriate to consider Etsuko a principal because Takehiko has a community property interest in High Innovation, it is appropriate to consider Etsuko and Takehiko partners. As noted above, co-ownership becomes a partnership when the parties intend to conduct business together. The significant functions that Etsuko performed for the company constitute objective evidence that she intended to conduct business with her husband, and was not merely a passive co-owner.

2. At the same time, the evidence indicates she did have reason to suspect that her husband was defrauding NPI. See Transcript from December 13, 1999 proceedings at 5-8.
